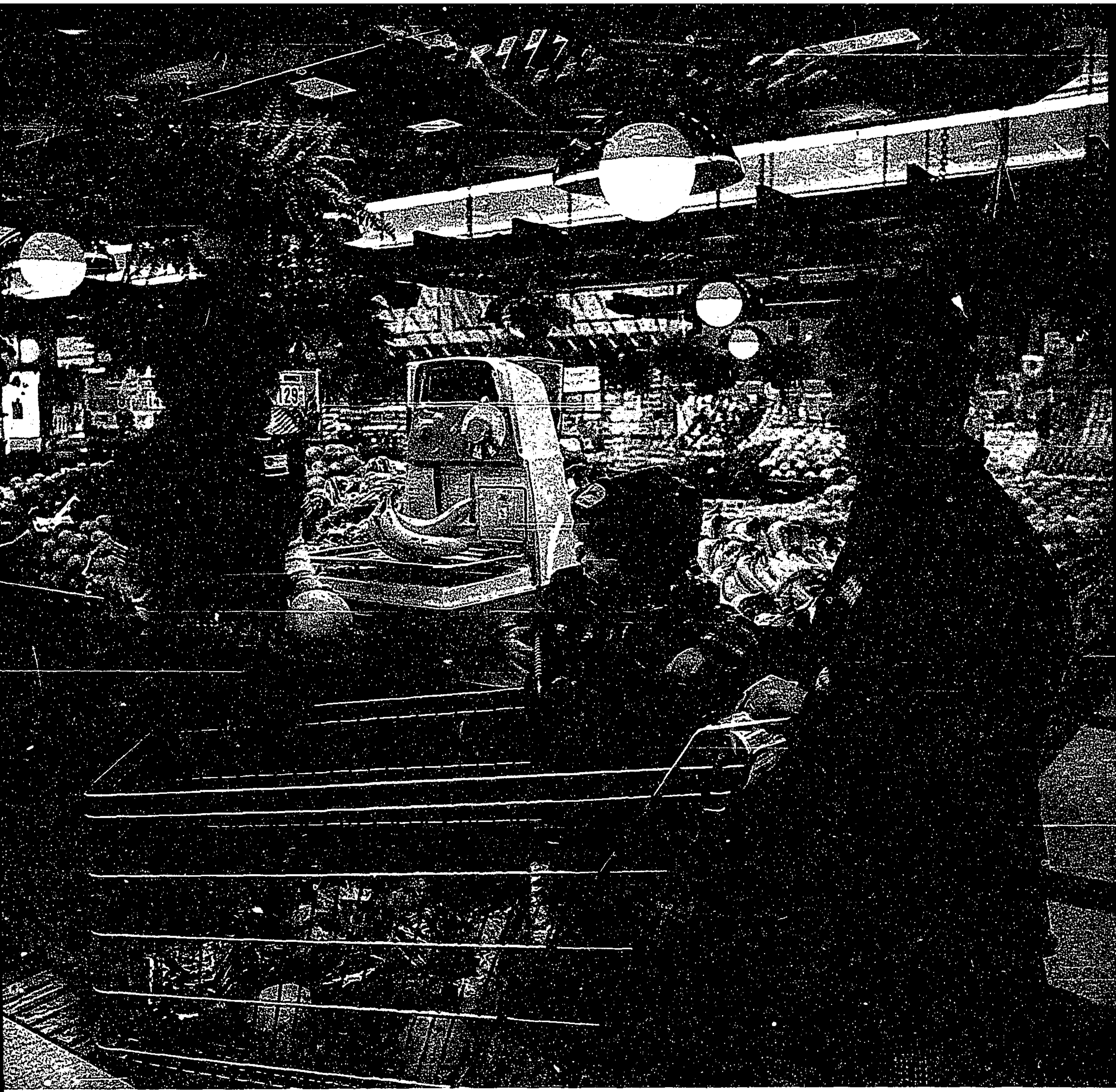


Kroger Co. 1977 Annual Report

The Kroger Co. 1977 Annual Report

Contents

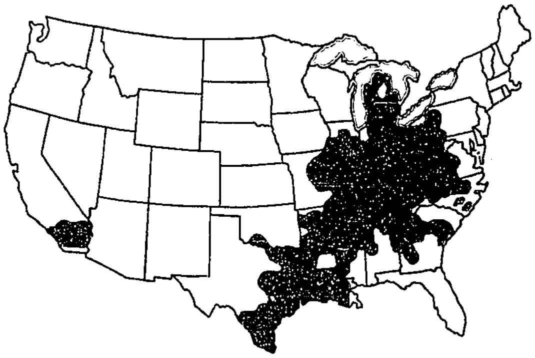
THE KROGER CO. is the sixth largest retailing company in the United States as ranked by total sales. The Company operates Kroger Food Stores, the country's third largest supermarket chain, with 1188 stores in 21 states at the end of 1977. As a result of an aggressive stores improvement program, more than 21 million square feet, or 75% of supermarket total square footage, is new or remodeled during the past six years. Most of these improved facilities are in the superstore category — 25,000 to 45,000 square feet in size, with specialty and personal-service departments such as delicatessens, bakeries, wine shops and greeting card departments.

Kroger also manufactures and processes food for sale by these supermarkets, a tradition which began before the turn of the century. The Company operates eight regional bakeries and five dairies in addition to a sausage plant, a cheese plant, egg production facilities, egg grading and packing plants, a peanut butter plant, a candy plant, and a general processing plant where such products as coffee, tea, preserves, salad dressings, spices, nuts and other items are processed. Other private label products are prepared for sale in Kroger stores by leading food processors throughout the country.

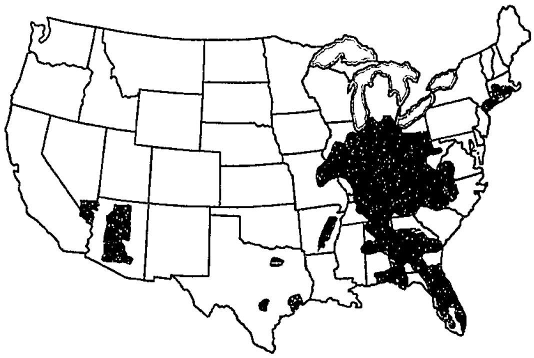
SupeRx Drug Stores, with 528 drug stores in 22 states at the close of 1977, is one of the country's largest drug store chains. Although SupeRx operates a majority of its drug stores in states where Kroger Food Stores are located, drug stores are also located in Arizona, Connecticut, Florida, New Jersey, New York and Nevada.

Top Value Enterprises is the nation's second largest trading stamp company, and also is active in the fields of business incentives, promotional continuity programs and travel services. Family Leisure Centers, the joint venture of Kroger and Taft Broadcasting Company, owns and operates theme amusement parks.

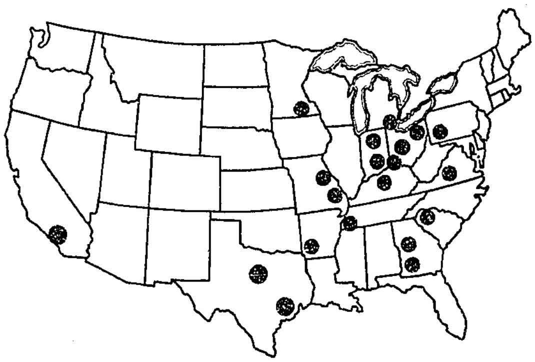
• **KROGER FOOD STORES**



• **SUPERX DRUG STORES**

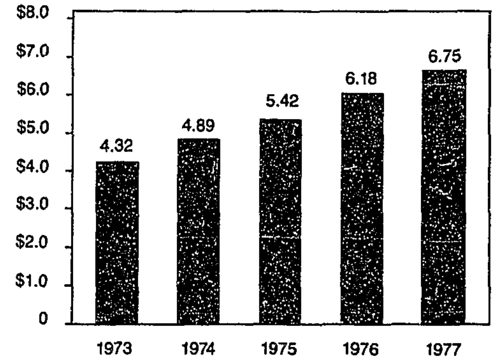


• **MANUFACTURING FACILITIES**

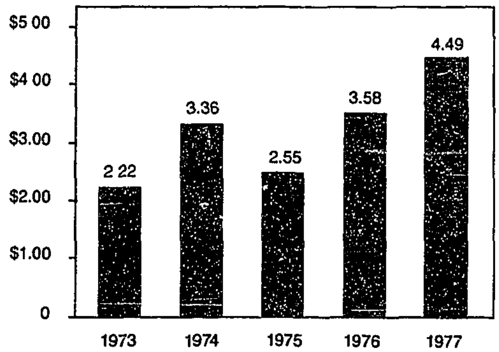


1014 Vine Street Cincinnati, Ohio 45201

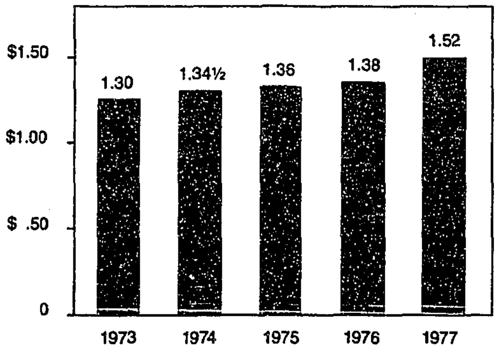
SALES (Billions)



NET EARNINGS PER SHARE



DIVIDENDS PER SHARE



1977 was the 76th consecutive year in which dividends have been paid out of current earnings

Financial Highlights

		1977		1976	Change
SALES	$	6,747,552,890	$	6,182,991,022	+ 9.1%
NET EARNINGS	$	60,646,554	$	48,330,946	+25.5%
DIVIDENDS PAID	$	20,550,673	$	18,576,949	+10.6%
SHAREOWNERS' EQUITY	$	493,118,248	$	457,794,801	+ 7.7%
PER COMMON SHARE					
NET EARNINGS		$ 4.49		$ 3.58	+$0.91
DIVIDENDS		$ 1.52		$ 1.38	+$0.14
SHAREOWNERS' EQUITY		$36.36		$33.89	+$2.47

A copy of the Company's 1977 report to the Securities and Exchange Commission, Form 10-K, is available to shareowners on request by writing: Irle R. Hicks, Treasurer, The Kroger Co., 1014 Vine Street, Cincinnati, Ohio 45201.

The annual meeting of shareowners will be held at the office of the Company, 1014 Vine Street, Cincinnati, Ohio on April 13, 1978 at 10 a.m.

TRANSFER AGENT AND REGISTRAR

The First National Bank
111 East Fourth Street
Cincinnati, Ohio 45202
Telephone: 513-852-4648

New York Stock Exchange Listing — Symbol KR.

James P. Herring **Lyle Everingham**

To our fellow shareowners:

Record sales and earnings were achieved in 1977. Improved results were due to a more effective operation throughout the company, particularly in the performance of our superstores and in the favorable reception of our merchandising programs by Kroger shoppers. Sales of $6.7 billion for 1977 (52 weeks) were up 9.1% from 1976 (53 weeks). Earnings of $60.6 million or $4.49 per share topped last year's earnings of $48.3 million or $3.58 per share by 25%.

The quarterly dividend rate was increased from 36¢ to 40¢ per share, effective with the third quarter of 1977. This is the third increase in the dividend since early 1974. Kroger has paid dividends from current earnings for 76 years — a record matched by only 81 other companies out of 1575 listed on the New York Stock Exchange.

Today, Kroger is realizing the benefits of the investment we have made in the company over the past six years. Our retail facilities are among the finest in the nation. They make possible and are supported by aggressive merchandising which is attracting an ever-increasing number of shoppers. Our employees are growing in knowledge and sophistication in operating these stores. Kroger has a number of strengths which have become increasingly evident during the past few years. In 1977, we were able to reach record results while coping with new competitive thrusts and marketing challenges in several key markets, along with continued escalation of operating costs — particularly in the areas of energy and labor.

A Look at 1977 . . .

The year 1977 was both a rewarding and a significant one for Kroger:

— Capital expenditures during the year totaled $96 million, primarily for continuation of the store modernization program. Ninety-eight new food stores were opened during the year, 35 stores were remodeled and 83 were closed. The bulk of closings of outdated stores is behind us. Consequently, this was the first year since 1970 in which we have opened more stores than we have closed, resulting in an increase in the number of food stores to 1188 at the end of 1977.

— The combination of fewer store closings and the increase in average store size produced a net gain of 1.8 million square feet of additional retail supermarket space. This is the largest year-to-year gain in net new space built or remodeled in one year in the history of the company, and represents a trend which will be an important factor in the company's progress in the years ahead.

— Our management organization has been restructured to strengthen the involvement of key executives — bringing a broader range of business talent to bear on Company decision-making and providing greater executive depth. John A. Cornett and William G. Kagler have been promoted to Senior Vice Presidents, and Richard M. Koster, William W. Oliver, John L. Strubbe and Charles L. Thomas, Jr., were named Group Vice Presidents. These executives have the experience and the knowledge necessary to provide leadership in carrying out the Company's objectives in the years to come.

— The superstore is our basic store today. Shopper response shows that it does provide the kind of food shopping that the majority of our customers want. In a number of locations, however, we also operate larger combination stores — food, drugs and general merchandise under one roof. At the end of 1977, we had 38 of this type store. The 1977 version — 13 Kroger Sav-On stores have been opened thus far, primarily in the Carolinas — had its roots in the similar Kroger Family Center stores in Texas.

— 1977 was a year of substantial improvement for SupeRx drug stores SupeRx management, through a streamlined organization, continues to improve merchandising and operating techniques. Sales of $527 million were up 4.3% from 1976. Pre-tax earnings were $13.2 million, an increase of $8.2 million from 1976 earnings of $5.0 million. During the year, SupeRx opened 11 new stores and sold or closed some 41 stores — allowing greater concentration of management effort on those areas which offer the greatest potential now and in the future.

Looking Ahead . . .

As we look to 1978, we see a year of continued growth:

— Capital expenditures for 1978 are expected to be approximately $110 million. Your Company has the necessary funds to finance our building program without additional borrowings.

— In the coming year, we plan to build new or remodel more than three and one-half million square feet of store space, representing 100 new and 25 remodeled stores and resulting in a net increase in total food store square footage of more than two million square feet. This new square footage represents obvious sales and profit opportunities for retailing, as well as growing potential for our food manufacturing operations as the added shelf space provides additional sales for our Kroger brand products. The percentage of our total food store space which is new or remodeled since the beginning of 1972 also continues to rise — with 75% of retail food store space now in this category, compared to 67.5% at the end of 1976. By the end of 1978, we expect that more than 80% of total square footage will be new or remodeled, further enhancing our merchandising capability.

— Kroger manufacturing will realize increased production capacity in 1978 from our recently-completed peanut butter processing plant in Georgia and from a new dairy in central Ohio which will open later in the year. The capacity of our Texas dairy also is being expanded to meet growing demand for our high-quality dairy products in that area.

— In 1978, SupeRx will continue to emphasize improved merchandising and operating performance. SupeRx plans to open 15 stores in the coming year. We expect the progress achieved in 1977 at SupeRx to continue as the drug stores return to a more acceptable level of profitability.

We have been encouraged by the growing recognition by labor of the need for improved in-store service to encourage sales. In a number of labor agreements, the Retail Clerks International Union has worked with us to help in improving customer service, including more effective use of front-end service employees. The increased customer patronage which comes from this better service results in more jobs, particularly for young people, who represent a large portion of the nation's unemployed. Customers, employees and the Company all benefit from this type of enlightened self-interest on the part of organized labor and management.

In recent years, many changes have taken place in the relationship between corporations and society. We believe our Company has responded to issues of consumerism, nutrition, corporate citizenship, affirmative action and others in a positive way and that we are a better Company for it. However, the most troublesome aspect has been the continued expansion of government into every phase of business. Government involvement has become one of the most significant factors in operating our business. Too many times in recent years, new laws have been passed or regulations adopted which needlessly restrict the latitude for management decision-making. Increasingly, a major portion of management time is spent in coping with government mandates, government-imposed paperwork and new costs brought on by government action. Our future is intertwined with this issue of the role of government. We believe government policymakers — and those charged with interpreting and enforcing laws and regulations — must become more aware of the impact of their actions on productivity and the cost of goods to the consumer.

Business could be more efficient if it were not carrying the unnecessary burden of so much non-productive government regulation. We are not willing to let this trend continue without voicing our concerns in a strong and vigorous manner. The best interest of our employees, customers, and shareowners lies in a cooperative relationship between government and business, based on an understanding of the proper role each can play in improving the economic and social well-being of all citizens. With your continued support, we pledge our efforts toward that goal.

We believe your Company has the strengths which will enable it to operate successfully in an industry where constant change, the pressure of intense competition and narrow profit margins are everyday challenges. No company can be successful without the support of dedicated and talented employees. People — at every level — have been our greatest asset in making the Company's programs work.

The vitality of the company, combined with continued improvement in store modernization and merchandising, should bring greater customer satisfaction, employee opportunity and shareowner rewards in the years ahead.

Sincerely,

James P. Herring

Chairman of the Board

Lyle Everingham

President

A DISCUSSION OF THE BUSINESS BY KROGER MANAGEMENT . . .

The following questions and answers summarize some of the areas of special interest to Kroger shareowners.

The Company has referred to the "maturing of the superstores" as a factor in its improvement. How long does it take a superstore to become profitable? When does a superstore reach its full sales and profit potential?

There can be wide variations, but on the average, a superstore achieves sufficient sales and becomes profitable in about a year. As to the superstore's full potential, we really do not know yet when maximum sales and profitability will be reached (*the group of superstores opened in 1974 and prior years still are growing!)*

How does Kroger categorize a superstore versus a standard supermarket?

Kroger superstores are 25,000 to 45,000 square feet in size — although most fall in the 30,000 to 35,000 square foot range. A typical superstore combines broad variety (up to 16,000 items compared to 8,000 in a standard supermarket) . . . favorite national and regional brands as well as a full assortment of Kroger Brand Products . . . personal-service departments such as delicatessens, bakeries and cheese shops . . . international and dietetic foods and a wine department . . . a wide assortment of convenient home and family-related products such as cookware and kitchen utensils, party items and candles, cosmetics, stationery and greeting cards. Produce departments — which feature "bulk" or loose produce — give shoppers a choice of tropical fruits, several different kinds of lettuces and Oriental vegetables as well as familiar fruits and vegetables. The meat department features not only pork, beef and poultry — but also high-quality veal, lamb and often fresh fish. Many smaller Kroger stores also provide some of these choices — but they are standard elements of a Kroger superstore. Another important point: These superstores, because of their broad appeal to shoppers, produce both more total sales and more sales per square foot . . . and from an operational standpoint, they are more efficient.

. . . Bountiful array of fresh fruits and vegetables.

How did Kroger decide to embark on its store modernization program in the early 1970s when many in the supermarket industry were pulling back on capital expenditures?

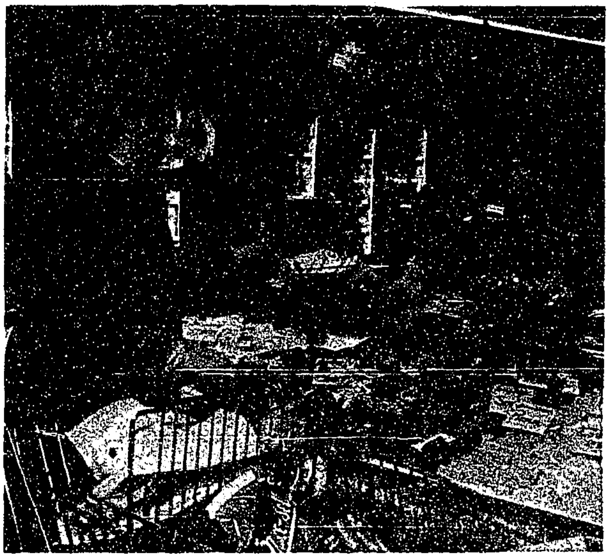
There was no other choice if Kroger was to show progress as we moved into the 70s and 80s. Even as far back as the beginning of the 1970s, the signs were clear that we must prepare ourselves in the light of increasing consumer expectations and rising operating costs.

The superstore — twice the size of the typical 16,000 square foot supermarket of the 1960s — provided the efficiency of operation and the merchandising variety which is necessary to satisfy customers and operate as we must today.

Kroger went into the superstore program with many basic strengths. Perhaps our greatest asset was the group of Kroger employees — talented, motivated, dedicated — who would be putting our plans into action. The Company's financial condition was sound and our warehousing and manufacturing back-up facilities were good. Both were of great assistance in implementing a planned improvement program for the stores.

In 1978, Kroger will increase its capital expenditures to $110 million (up from $96 million in 1977 and $82 million in 1976). Why are you increasing your capital expenditures?

In order to maintain vitality and momentum, store modernization must be a continuing process. Also, an



Sampling the product helps sell.

obvious factor is the rising cost of construction. Kroger was able to complete a large part of its store modernization at considerably lower cost than would be the case if we were just starting to build those same stores today. But just as a merchandising program must grow and develop as the needs of shoppers change, so too must stores be updated and new stores built. Our store improvement program was not a one-time, one-year or even a five-year event. Kroger has a long-term commitment — to our customers, to our employees and to our shareowners — to become known as the store which does a better job serving shoppers' needs than any other food merchant. This is accomplished through the medium of the superstore — and expansion of these facilities as well as keeping them up to date is a necessary part of our continued success.

How many stores have you closed, built new or remodeled since the beginning of 1972?

From 1972 through 1977, we have closed 725 older, smaller and often unprofitable stores. At the same time, we have opened nearly 800 new or remodeled stores offering better shopping service and greater efficiency . . . and preparing us to take the steps necessary to implement the merchandising programs which meet the needs of today's shoppers.

Kroger has withdrawn from some markets with no immediate potential for improvement and you have stated that your capital dollars are being channeled to growth markets. Can you give an example to demonstrate what this can mean?

There are many markets where this development has occurred. An excellent example is Atlanta, Georgia. We are competing there with many fine regional chains, as well as other national companies. Kroger back in 1971 had major problems, primarily stemming from stores that were too small and old — and a resulting inability to respond to changing consumer needs. The 26 stores in the Atlanta metro area at the time averaged less than 16,000 square feet. As a group, they were unprofitable. Unlike some other markets where we had this situation and saw little hope of immediate improvement, we could see strong potential which was worthy of our investment monies.

Today we have turned that picture around. We have opened 18 new superstores, remodeled 10 and closed 13 . . . and we now operate 31 stores in that market. Our total square footage in Atlanta has increased 85% and average store size is 25,390 square feet. We are a vibrant part of Atlanta's growth and our stores are increasingly recognized as the finest in Atlanta *(as measured by consumer research and as evidenced by our steadily-building number of customers)*. Our patronage is growing — not just because we have bigger stores, but because we have used our improved facilities to offer better overall food shopping.

What percent of food store sales comes from Kroger's own products? To what do you attribute their popularity?

Approximately 25% of food store sales are accounted for by Kroger's own brand products — both those which are made in our own plants and those which are made to our specifications by leading outside food manufacturers. Shoppers like the lower prices, of course, and once they discover that they can get high quality as well, they usually become repeat customers.

. . . Foods from around the world.

Kroger Peanut Butter . . . in sizes to suit the family.

At the same time, Kroger Manufacturing is moving aggressively to respond to trends in the public taste *(yogurt, for example, not only comes in two types and several flavors, but there's also a new frozen yogurt line which immediately received customer approval because of its superior flavor and quality).* Using another example, the growth pattern of Kroger Peanut Butter has paralleled the introduction of new sizes designed to meet family needs *(up to a five-pound pail which can be used in Junior's sandbox after the peanut butter has been consumed).*

And once again, the larger superstore allows the space to display adequately both national and regional favorite brands in addition to Kroger's own brand products.

Friendly service is key part of total Kroger meat quality.

You continue to talk about the meat superiority program. What are the results?

Kroger marketing areas made significant progress during 1977, and our reputation for meat quality improved noticeably as measured by consumer research. Kroger variety also is starting to stand out from competition — not only in availability of cuts but also in the excellent choice of high-quality veal and lamb — now a standard part of our meat offering. (The American Sheep Producers Council wrote recently: *"If there has been a note of optimism in the sheep business lately, a large measure of it is due to the excellent program which Kroger has developed for lamb.")* The popularity of chill-pack chickens, now available throughout the company, is spreading to fresh chill-pack turkeys which represent the fastest-growing poultry item.

We are continuing our program to establish Kroger as the food store with the finest meats. Kroger's quality meat program is part of our total effort to offer the best perishable products in each town in which we operate — produce, dairy products, eggs, baked goods and meat.

Yogurt . . . variety is response to consumer taste trends.

Kroger instituted a similar program to improve produce quality a couple of years ago. What has customer reaction been to the bulk produce and improved quality?

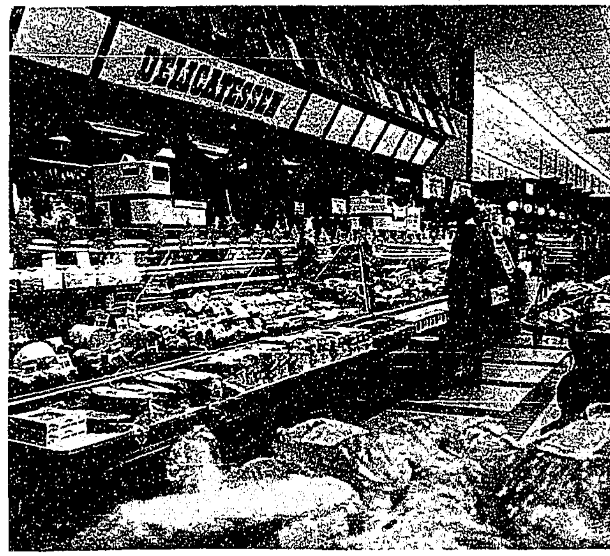
Our produce program has been an unqualified success . . . and we believe it has been successful because it was a direct response to what consumers were telling us. A few years ago, Kroger — like many supermarkets — carried almost 100% prepackaged fresh fruits and vegetables. It was neat and convenient . . . but our research began to show stronger and stronger indications that shoppers preferred "bulk" or loose produce. As a result, we made the decision to give them the choice of buying as little or as much as they want . . .

to provide wide variety. . . to have an attendant on the floor to weigh their purchase or answer questions . . . and importantly, we made a commitment to buy only the top quality available. Today shoppers rank our produce departments at the top of the list of Kroger's qualities. This is confirmed by produce sales, which have been consistently ahead of overall sales growth.

There has been a lot of talk in the food industry recently about the growing percentage of the consumer's food dollar that is being spent at fast-food outlets. What's Kroger's opinion?

We really do not see fast-food outlets as a direct competitor to supermarkets. Rather, we look at the popularity of fried chicken and pizza and other such foods as a merchandising opportunity. Supermarkets — if they are alert to the potential sales — can provide the product, often in more variety and usually at lower cost. Take pizza, for example. A few years ago, Kroger carried a dry pizza mix in the grocery department, and that was about it. In our superstores today, shoppers can buy several different brands and sizes of frozen prepared pizza with just about any topping imaginable . . . they can buy the ingredients and make their own . . . or in our delicatessen departments, they can order a fresh pizza ready to be carried home and popped into the oven. This is just one example of how we are merchandising to consumer tastes.

. . . Full menu of pizzas in a Kroger superstore.



Colorful, appetizing delicatessens!

What about the special-service departments in superstores, such as delicatessens, bakeries and cheese shops . . . do customers respond to these departments and are you continuing to install them?

Enthusiastically! Like our colorful produce departments, delicatessens and bakeries tell shoppers that a superstore is more than an ordinary supermarket. They sell convenience, but also friendly, personal service. One of the secrets of our successful delicatessen operations is consistency and high quality . . . week in and week out. We want shoppers to find the same high standards in any of the 653 Kroger delicatessen/bakery departments. About one-third now have the capability of preparing and baking bread and pastries right in the store . . . adding the aroma of fresh-baked goods to the overall appeal. Many also have accompanying cheese shops which offer a wide variety of imported and U.S. cheeses cut *"to order."*

. . . Hot carryout meals.

Lillian Mullins, right, 10-year Kroger employee, advises shopper in new cosmetics department.

Larger stores provide the opportunity to sell more higher-markup general merchandise items. How does Kroger view general merchandise?

Today, as much as 20% of a store's selling space is for general merchandise items. A key reason for the growth at Kroger lies in upgraded quality and expanded variety. New for 1977 was the installation in a number of stores of an attractive, wood-grained and mirrored cosmetics aisle which provides shoppers with the newest and most popular brands of cosmetics . . . once again contributing to the ease of one-stop shopping and customer satisfaction. We are also finding that customers want and will buy higher quality in cookware, for example, than had traditionally been considered for a supermarket . . . just as they want higher quality in perishables.

. . . Live plants are popular items for superstore shoppers.

You mention consumer research. What kind of consumer research does Kroger do?

This is a continuing program. In our formalized consumer research, we talk with more than 22,000 shoppers each year . . . getting their opinion on how well Kroger *(and our competition)* serve shoppers. Just as important as finding out those areas where we rank high is to know where we need improvement. We listen and we respond to what they tell us *(our produce and meat superiority programs were direct responses to consumer research, for example).*

Would you summarize what you see as Kroger's major strengths today that will help you tomorrow? What do you see as the most significant challenges for the future?

Kroger's major strengths today are:

- *We have probably the most modern chain of stores in the U.S., with 75% new or remodeled.*
- *We have a well-developed business plan that helps bring discipline to our activities. We operate to that plan, updating it each year for future years.*
- *We have employees who have the knowledge and dedication to carry out these plans.*
- *Our merchandising is being revitalized through our determination to be recognized not only for prices which represent a value but also for high quality — particularly in perishables.*
- *Our Kroger manufacturing plants operate more efficiently as sales of these fine products continue to mount.*

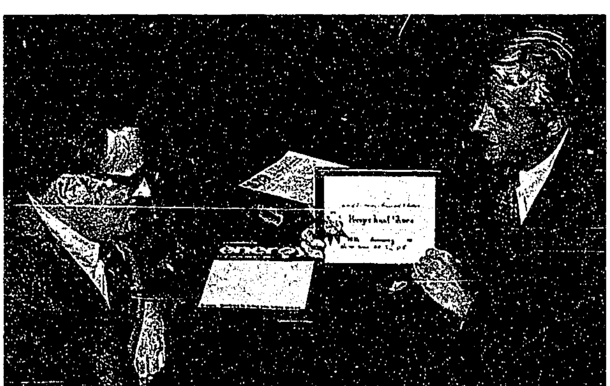
There also are some challenges — inflation and the cost of services, products, labor and energy, all of which are rising at a faster rate than can be recovered in markup . . . energy, both from the standpoint of the international situation and its possible effect on supplies and costs and from shortages created by labor work stoppages such as the coal strike . . . managing against the ever-increasing amount of time and corporate resources that have to be utilized in interpreting and complying with the growing number of government regulations and paperwork . . . and in a labor-intensive industry, certainly the accelerated cost of labor (more than two-thirds of a supermarket's operating costs go for labor) and lack of productivity improvement. All of these are factors which require continuing effort on our part, along with close tracking with the consumer's shopping patterns and tastes.

On balance, however, we believe that Kroger today has greater strength to maintain its forward momentum than at any time in our history.

... Cheese — to your order.

Would you comment on the energy situation?

In the area of energy, the Company has taken leadership in the industry in a vigorous energy conservation program — both to use natural gas and electricity efficiently and because it is in the overall public interest. In spite of this, the increase in utility rates has caused a significant rise in the cost of energy throughout the company. There is no question that as the federal energy policy is resolved, the cost of energy will continue to escalate, putting greater pressure on management to continue to conserve. At the same time, the public must recognize that these increased costs are ultimately reflected in retail prices.



"The energy conservation example set by Kroger is one other businesses would do well to follow," said Indiana Lt. Gov. Robert D. Orr, right, in presenting citation to Theodore Engel, Central Marketing Area vice president. This is the highest award given by the State of Indiana in the area of energy conservation.

Many companies are becoming more involved in the areas of civic and community affairs. What is Kroger's philosophy of corporate responsibility?

It is an essential part of doing business today — both an opportunity and an obligation to the public we serve. We agree with a Wall Street Journal article which said: *"A company's contribution to society may be measured best by observing over a period of time its profitability, its responsiveness to customer's needs, and its accountability to society's expectations of good corporate citizenship."* We are taking a more active role in being involved with issues that affect our business. We encourage our employees to be active in civic and community affairs. Through our companywide charitable giving program, we insure that Company resources are used to help support worthy cultural, civic, health and education needs in the communities where we operate. We believe that good corporate citizenship and operation of a healthy, profitable Company go hand in hand. Each supports the other.

Donna Arrington, above, head cashier for the Bryan, Texas, store, was the 1977 winner of the B. H. Kroger Award for the Houston Marketing Area. The award, named for the Company's founder, recognizes Kroger employees for outstanding community service. Donna's activities center around helping children, particularly those with learning disabilities.

Management's Analysis of Summary of Operations

The following is an analysis of the Company's operations for the years 1975, 1976 and 1977, and should be read in conjunction with the Consolidated Statement of Earnings (page 12), Operating Results by Segments of Business, (page 11), and the Five Year Summary (page 20).

The Company's sales increased 9.1% in 1977 over 1976 due to an increase in the number of food stores, increased sales in existing stores and increases in price levels. In 1976, the Company's sales increased 14.1% over 1975. This increase was comprised almost entirely of increased unit volume, due in part to the fact that 1976 included 53 weeks, compared to 52 weeks in 1975. Removing the effect of the additional week in 1976, the sales increase over the prior year was 11.1% in 1977 and 12.0% in 1976.

In 1977 the Company's net earnings reached a record high of $60,647,000, an increase of $12,316,000, or 25.5% over 1976. Earnings improved in both the food and drug store operations. The Company's major investment over the past six years in larger more efficient food stores continued to reach fruition through increased sales and profits. Pre-tax earnings of SupeRx Drug Stores improved to $13,223,000 as they responded to more effective merchandising and more efficient operation.

The Company's net earnings increased 40.3% to $48,331,000 in 1976 from the $34,441,000 reported in 1975. Earnings from food operations improved principally as a result of increased sales and successful expense control efforts. A growing number of larger superstores began to reach maturity, and the continued closings of smaller and unprofitable stores, including the discontinuance of operations in the Kansas City area (22 stores) also contributed to improved food operations. Drug store earnings declined in 1976; however, the year's pre-tax earnings of $5,005,000 reflected a strong finish after a loss of $2,400,000 in the first half of the year. Slow maturing of the new larger drug stores opened since 1971 plus increases in operating expenses, particularly employee and utility costs, materially affected 1976 drug store results Net earnings of Top Value were $995,000 in 1976. The improvement was affected by two non-recurring items — a reduction in the liability for unredeemed trading stamps offset in part by a provision for costs relating to the closing of excess redemption facilities and other expenses resulting from the reduced level of operations of Top Value. Combined, these two non-recurring items increased Top Value's net earnings by $1,820,000 during the third quarter of 1976.

In spite of improved expense control disciplines installed in the past few years, the Company's operating,general and administrative expenses increased substantially during 1976 and 1977. Significantly higher wage and utilities costs were the major causes of these increases in both years. Rent and depreciation for the past three years have continued to increase because of the Company's continuing program of opening increased numbers of larger food stores. Interest on long-term debt has increased as a result of additional borrowings to finance this store program; the most recent borrowing occurred in December of 1976. Interest income rose substantially from 1975 to 1976 due to temporary investment of funds derived from improved management of working capital, as well as certain funds provided by long-term borrowings.

Capital Expenditures

Capital expenditures for 1977 totaled $96,417,000, up from $81,906,000 in 1976. Expenditures in 1977 included $59,875,000 or 62% of the total for retail stores and related equipment; $20,989,000 for food processing facilities and equipment; and $9,428,000 for vehicles and distribution center facilities and equipment. Investment tax credits in 1977 amounted to 61¢ per share compared to 52¢ per share in 1976. Capital expenditures for 1978 are projected to be approximately $110,000,000, the major portion of which will continue to be spent for retail stores and related equipment. Funds needed in 1978 for the capital expenditure program will come from temporary cash investments and internally generated funds.

Dividends

Dividends of $1.52 per common share were paid in 1977 which marks the 76th consecutive year in which dividends have been paid out of current earnings. Dividends of 34¢ per share were paid in each of the first three quarters of 1976. The dividend was increased to 36¢ per share in the fourth quarter of 1976 and continued at that amount for each of the first two quarters of 1977. It was again increased to 40¢ per share for the third quarter of 1977 and continued at that amount for the fourth quarter. This latest increase was the third since early 1974. The regular quarterly dividend of 40¢ per share payable March 1, 1978, to shareowners of record February 1, 1978, was declared on January 20, 1978.

Quarterly Results

Sales for the 12 week fourth quarter of 1977 were $1,685,847,423, an increase of 4.9% over the 13 week fourth quarter of 1976. Earnings of $18,821,003 or $1.40 per share increased 14.0% from $1.22 per share earned in the fourth quarter 1976. Quarterly sales, merchandise costs (including warehousing and transportation), earnings, earnings per share and common stock price range for 1977 and 1976 were as follows:

	Sales In Millions		Merchandise Costs In Millions		Earnings In Millions		Earnings Per Share		Common Stock Price Range	
	1977	1976	**1977**	1976	**1977**	1976	**1977**	1976	**1977**	1976
1st (12 weeks)	**$1,470**	$1,344	**$1,146**	$1,059	**$10.5**	$ 8.7	**$ .78**	$ .65	**27½ - 23⅝**	20¾ - 17⅝
2nd (12 weeks)	**1,526**	1,379	**1,186**	1,084	**15.4**	10.4	**1.14**	.77	**26⅜ - 24¼**	20⅛ - 18⅛
3rd (16 weeks)	**2,066**	1,852	**1,617**	1,456	**15.9**	12.7	**1.17**	.94	**28¾ - 25⅛**	25¼ - 18¾
4th (12 weeks) (a)	**1,686**	1,608	**1,321**	1,257	**18.8**	16.5	**1.40**	1.22	**27¾ - 23¼**	24⅞ - 21⅛
	$6,748	$6,183	**$5,270**	$4,856	**$60.6**	$48.3	**$4.49**	$3.58		

(a) 13 weeks in 1976

Operating Results by Segments of Business

Sales for the 52 weeks ended December 31, 1977 were $6,747,552,890, an increase of 9.1% over the 53 week year ended January 1, 1977. Net earnings were $60,646,554, an increase of 25.5% over 1976. Sales and earnings (after deducting interest expense and general corporate expense allocated to the segments of business) by principal segments of business for the five years 1973 through 1977 were as follows:

	1977	1976	1975	1974	1973
Sales:		(in millions of dollars)			
Food Business	**$6,221**	$5,678	$4,963	$4,503	$3,972
Drug Stores	**527**	505	458	390	348
Total	**$6,748**	$6,183	$5,421	$4,893	$4,320
Earnings:					
Food Business	**$ 92.5**	$ 79.4	$ 51.9	$ 64.3	$ 37.0
Drug Stores	**13.2**	5.0	6.7	16.9	16.2
	$105.7	$ 84.4	$ 58.6	$ 81.2	$ 53.2
Taxes based on income	**46.6**	37.1	24.7	36.7	23.6
	$ 59.1	$ 47.3	$ 33.9	$ 44.5	$ 29.6
Equity in net earnings of unconsolidated companies	**1.5**	1.0	.5	.7	.3
Net earnings	**$ 60.6**	$ 48.3	$ 34.4	$ 45.2	$ 29.9

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

To the Shareowners and Board of Directors
The Kroger Co.

We have examined the consolidated balance sheets of The Kroger Co. and Consolidated Subsidiary Companies as of December 31, 1977 and January 1, 1977, and the related consolidated statements of earnings, accumulated earnings and changes in financial position for the fiscal years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. For fiscal 1976 we did not examine the financial statements of Top Value Enterprises, Inc., a wholly-owned subsidiary, which statements reflect total assets constituting 9.2% of the related 1976 consolidated total. These statements were examined by other independent certified public accountants whose report thereon has been furnished to us and our opinion for fiscal 1976 expressed herein, insofar as it relates to the amounts included for Top Value Enterprises, Inc.,is based solely upon the report of the other accountants.

In our opinion, based upon our examinations and the report of other accountants in fiscal 1976, the financial statements referred to above present fairly the consolidated financial position of The Kroger Co. and Consolidated Subsidiary Companies at December 31, 1977 and January 1, 1977, and the consolidated results of their operations and changes in their financial position for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis after restatement for the change, with which we concur, in the consolidation policy as described in Notes to Consolidated Financial Statements.

Coopers & Lybrand
3800 Carew Tower
Cincinnati, Ohio 45202
February 17, 1978

Coopers & Lybrand

CONSOLIDATED STATEMENT OF EARNINGS

Years Ended December 31, 1977 and January 1, 1977	**1977 (52 Weeks)**	1976 (53 Weeks)
Sales	**$6,747,552,890**	$6,182,991,022
Costs and Expenses:		
Merchandise costs, including warehousing and transportation	**$5,269,659,364**	$4,855,880,788
Operating, general and administrative expenses	**1,200,580,654**	1,082,515,386
Rent	**102,175,835**	96,505,559
Depreciation and amortization	**56,929,780**	52,948,319
Dividend and interest income	**(8,455,217)**	(7,305,311)
Interest expense on long-term debt	**20,140,042**	16,920,452
Other interest expense	**766,665**	1,155,058
Taxes based on income	**46,612,380**	37,081,939
Total	**$6,688,409,503**	$6,135,702,190
Earnings before equity in net earnings of unconsolidated companies	**$ 59,143,387**	$ 47,288,832
Equity in net earnings of unconsolidated companies	**1,503,167**	1,042,114
Net earnings	**$ 60,646,554**	$ 48,330,946
Average number of shares of common stock outstanding	**13,519,671**	13,495,039
Net earnings per share of common stock	**$ 4.49**	$ 3.58

CONSOLIDATED STATEMENT OF ACCUMULATED EARNINGS

Years Ended December 31, 1977 and January 1, 1977	**1977**	1976
Accumulated earnings — Beginning of the year	**$ 386,285,834**	$ 356,531,837
Net earnings for the year	**60,646,554**	48,330,946
	$ 446,932,388	$ 404,862,783
Dividends on common stock — $1.52 per share in 1977 and $1.38 per share in 1976	**20,550,673**	18,576,949
Accumulated earnings — End of the year	**$ 426,381,715**	$ 386,285,834

The accompanying notes are an integral part of the financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

Years Ended December 31, 1977 and January 1, 1977	**1977 (52 Weeks)**	1976 (53 Weeks)
SOURCES OF WORKING CAPITAL		
From operations:		
Net earnings	**$ 60,646,554**	$ 48,330,946
Charges (credits) to earnings not involving funds:		
Depreciation and amortization	**56,929,780**	52,948,319
Provision for deferred federal income taxes	**9,888,295**	9,575,590
Equity in net earnings of unconsolidated companies	**(1,503,167)**	(1,042,114)
Total from operations	**$125,961,462**	$109,812,741
Capital stock issued under option plans	**1,739,211**	300,075
Additions to long-term debt		56,465,958
Marketable inves..nent securities sold	**11,006,692**	6,238,124
Sale of property subsequently leased back		9,100,000
Net book value of fixed asset disposals	**9,855,079**	14,912,794
Other changes, net	**200,011**	677,941
Total sources	**$148,762,455**	$197,507,633
USES OF WORKING CAPITAL		
Capital expenditures	**$ 96,416,593**	$ 81,905,931
Dividends paid	**20,550,673**	18,576,949
Investment in unconsolidated company	**15,000,000**	
Reduction of unredeemed trading stamps	**58,922**	7,193,935
Reduction of long-term debt	**17,404,603**	6,067,110
Employees' benefit fund payments, net of provision	**2,172,146**	1,832,146
Purchase of capital stock for treasury	**896,657**	
Total uses	**$152,499,594**	$115,576,071
Net increase (decrease) in working capital	**$ (3,737,139)**	$ 81,931,562

ANALYSIS OF WORKING CAPITAL CHANGES

	Increase (Decrease)	
Current asset changes:		
Cash and short-term investments	**$(19,234,578)**	$ 74,143,703
Inventories	**65,298,323**	58,237,131
Other current assets	**9,871,157**	6,115,479
Net increase in current assets	**$ 55,934,902**	$138,496,313
Current liability changes:		
Current portion of long-term debt and notes payable	**$ (8,476,111)**	$ 3,895,419
Accounts payable	**54,135,140**	32,142,903
Accrued expenses and taxes	**14,009,081**	27,720,364
Current portion of unredeemed trading stamps	**(58,922)**	(7,193,935)
Current portion of obligations under capital leases	**62,853**	
Net increase in current liabilities	**$ 59,672,041**	$ 56,564,751
Net increase (decrease) in working capital	**$ (3,737,139)**	$ 81,931,562

The accompanying notes are an integral part of the financial statements.

CONSOLIDATED BALANCE SHEET

ASSETS	DEC. 31, 1977	JAN. 1, 1977
CURRENT ASSETS		
Cash	$ 16,521,486	$ 28,724,159
Short-term investments, at cost, which approximates market	119,157,808	126,189,713
Receivables	68,658,753	61,579,768
Inventories	623,645,288	558,346,965
Store and general supplies	7,728,850	8,073,799
Prepaid and other current assets	26,517,865	23,380,744
Total current assets	$ 862,230,050	$ 806,295,148
INVESTMENTS		
Marketable investment securities	$ 28,442,085	$ 45,063,765
Investments in and advances to unconsolidated companies	43,281,511	26,622,385
Other investments, at cost	7,370,999	5,920,166
Total investments	$ 79,094,595	$ 77,606,316
PROPERTY, PLANT AND EQUIPMENT		
Land	$ 14,189,891	$ 14,894,621
Buildings	80,476,555	80,464,968
Equipment	509,969,465	463,184,072
Leaseholds and leasehold improvements	166,939,019	159,936,945
Leased property under capital leases	3,403,527	
	$ 774,978,457	$ 718,480,606
Allowance for depreciation and amortization	321,710,959	296,363,852
Property, plant and equipment, net	$ 453,267,498	$ 422,116,754
OTHER ASSETS		
Excess of cost of investments in consolidated subsidiaries over equities in net assets	$ 19,339,394	$ 19,351,288
Total Assets	$1,413,931,537	$1,325,369,506

LIABILITIES

	DEC. 31, 1977	JAN. 1, 1977
CURRENT LIABILITIES		
Current portion of long-term debt	**$ 5,805,154**	$ 5,381,265
Notes payable		8,900,000
Accounts payable	**343,789,464**	289,654,324
Accrued expenses	**149,615,964**	140,839,659
Accrued federal income and other taxes	**37,569,120**	32,336,344
Current portion of unredeemed trading stamps	**26,926,973**	26,985,895
Current portion of obligations under capital leases	**62,853**	
Total current liabilities	**$ 563,769,528**	$ 504,097,487
OTHER LIABILITIES		
Long-term debt	**$ 215,578,291**	$ 232,982,894
Unredeemed trading stamps	**26,926,973**	26,985,895
Deferred federal income taxes	**79,290,159**	69,401,864
Employees' benefit fund	**31,934,419**	34,106,565
Obligations under capital leases	**3,313,919**	
Total other liabilities	**$ 357,043,761**	$ 363,477,218
Total Liabilities	**$ 920,813,289**	$ 867,574,705

SHAREOWNERS' EQUITY

	DEC. 31, 1977	JAN. 1, 1977
Common capital stock, par $1, at stated value		
Authorized: 18,000,000 shares		
Issued: 1977 — 13,852,126; 1976 — 13,763,206	**$ 90,661,044**	$ 88,921,833
Accumulated earnings	**426,381,715**	386,285,834
	$ 517,042,759	$ 475,207,667
Common stock in treasury, at cost 1977 — 290,227 shares; 1976 — 256,673 shares	**9,658,091**	8,761,434
Net unrealized loss on marketable equity securities	**14,266,420**	8,651,432
Total Shareowners' Equity	**$ 493,118,248**	$ 457,794,801
Total Liabilities and Shareowners' Equity	**$1,413,931,537**	$1,325,369,506

The accompanying notes are an integral part of the financial statements.

ACCOUNTING POLICIES

The following is a summary of the significant accounting policies followed in preparing the Company's financial statements. These policies conform to generally accepted accounting principles and have been consistently applied after restatement for the change in the consolidation policy.

Principles of Consolidation

The consolidated financial statements include the Company and all of its subsidiaries. Certain partially-owned affiliated companies are included in the financial statements on the equity basis.

In 1977, the Company adopted the policy of including Top Value Enterprises, Inc., a subsidiary company, on a consolidated basis. This subsidiary had previously been reported on the equity basis. The change in consolidation policy had no effect on 1977 or previously reported net earnings, although certain individual financial statement categories were restated for 1976 to give retroactive effect to this policy.

Inventories

The inventories are valued at the lower of cost or market with cost determined on the retail and first-in, first-out methods.

Marketable Investment Securities

Marketable investment securities consist of bonds, notes and common and preferred stocks held for long-term investment. Dividend and interest income are accrued as earned. The cost of marketable investment securities sold is determined on the specific identification method.

Marketable equity securities (common and preferred stocks) are carried at the lower of cost or market. A valuation allowance, representing the excess of cost over market of these equity securities, is included in shareowners' equity. Other marketable investment securities (bonds and notes) are carried at cost unless there is a permanent impairment of value, at which time the securities are valued at market. In management's opinion there is no indication of a permanent loss in value in any portion of the portfolio and there is no present intention to liquidate the securities portfolio at less than cost.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation and amortization, which includes the amortization of assets recorded under capital leases, is computed principally on the straight-line basis. All maintenance and repairs are charged to earnings. Betterments and renewals which increase the value or productive capacity of assets are capitalized.

Excess of Cost of Investments in Consolidated Subsidiaries Over Equities in Net Assets

The excess of cost of investments in consolidated subsidiaries over equities in net assets at dates of acquisition originating prior to November, 1970 is not being amortized because, in the opinion of management, there has been no decrease in value. Amounts arising after October, 1970 are not significant and are being amortized on the straight-line basis over forty years.

Unredeemed Trading Stamps

Trading stamp revenues and the related estimated costs of redemption, including the cost of merchandise and related redemption expenses, are recorded at the time the stamps are issued.

Previous redemption experience indicates that approximately 50% of the stamps outstanding are not presented for redemption within one year. Accordingly, one-half of the unredeemed trading stamp liability is classified as a non-current liability.

Deferred Federal Income Taxes and Investment Tax Credit

Deferred federal income taxes include the amount of tax applicable to the excess of depreciation for tax purposes over depreciation used for financial reporting purposes and the amount of tax applicable to the change in 1973 from the LIFO (last-in, first-out) to the FIFO (first-in, first-out) method of inventory valuation, less the amount of tax applicable to the excess pension expense (related to the unfunded pension liability) and costs of redemption included in the liability for unredeemed trading stamps which are not allowed for current tax purposes.

Investment tax credits are included as reductions of income tax expense in the years in which the credits are used.

NON-RECURRING ITEMS

The Company performs a periodic statistical study of its stamp redemption experience. Based upon the Company's experience, as supported by this study, net earnings for 1976 were increased by $3,900,000 resulting from a reduction of the liability for unredeemed trading stamps. Net earnings for 1976 also include costs of $2,080,000 related to the closing of excess stamp redemption facilities and other expenses resulting from the reduced level of trading stamp activity. Combined, these two non-recurring items increased the Company's net earnings for 1976 by $1,820,000, after applicable taxes, or 13¢ per share of common stock.

PENSION PLANS

The Company has three noncontributory retirement plans for eligible employees, two of which have historically been funded. The third retirement plan, which was previously unfunded, is being funded over a period of forty years beginning in 1976. The Company also contributes to multi-employer plans jointly administered by management and union representatives.

The actuarially computed value of vested benefits for the Company administered plans as of December 31, 1977 exceeded the total of the pension funds and balance sheet accruals by approximately $50,824,000. Past service costs for the Company's plans are being amortized over forty years.

The total pension expense for all plans for 1977 and 1976 was $48,530,591 and $43,662,297, respectively.

LEASES

The Company operates principally in leased premises. Lease terms generally range from ten to twenty-five years with options of renewal for additional periods. Options provide in some cases for reduced rentals and/or the right to purchase.

Lease arrangements entered into in 1977 have been classified as capital leases or operating leases in accordance with Statement of Financial Accounting Standards No. 13 which became effective for 1977.

Rent expense for 1977 and 1976 consists of:

	1977	1976
Minimum rentals, net of minor sublease rentals	$ 95,191,032	$89,705,575
Contingent rentals, operating leases	6,984,803	6,799,984
Total	$102,175,835	$96,505,559

Certain of the leases provide for contingent rental based upon a percent of sales. No contingent rentals were incurred for capital leases during 1977.

Assets recorded under capital leases as of December 31, 1977 consist of:

Store facilities	$3,403,527
Less accumulated amortization	(77,752)
	$3,325,775

Minimum annual rentals, net of subleased rentals which are minor in amount, for the five years subsequent to 1977 and in the aggregate are as follows:

	Capital Leases	Operating Leases
1978	$ 412,956	$ 96,041,000
1979	412,956	92,310,000
1980	412,956	88,912,000
1981	412,956	85,919,000
1982	412,956	82,951,000
1983 and thereafter	6,022,275	925,453,000
	$8,087,055	$1,371,586,000
Less estimated executory costs included in capital leases	685,279	
Net minimum lease payments under capital leases	$7,401,776	
Less amount representing interest	4,025,004	
Present value of net minimum lease payments under capital leases	$3,376,772	

Lease arrangements entered into prior to 1977 have been accounted for as operating leases. Had such leases been accounted for in accordance with Statement of Financial Accounting Standards No. 13, the following amounts of assets and liabilities would have been recorded as of the dates indicated:

	Dec. 31, 1977	Jan. 1, 1977
Total capital leases, net of accumulated amortization	$101,057,000	$105,894,000
Total obligations under capital leases	$103,508,000	$108,010,000

Capitalization of lease arrangements entered into prior to 1977, in accordance with Statement of Financial Accounting Standards No. 13, would have reduced net earnings by an estimated $335,000 for the year ended December 31, 1977 and by an estimated $235,000 for the year ended January 1, 1977.

MARKETABLE INVESTMENT SECURITIES

Marketable investment securities include:

	1977	1976
Equity securities, at cost	$ 34,193,635	$ 40,654,944
Less valuation allowance	(14,266,420)	(8,651,432)
Equity securities, at market	$ 19,927,215	$ 32,003,512
Bonds and notes, at cost	8,514,870	13,060,253
	$ 28,442,085	$ 45,063,765

Marketable investment securities earned $1,015,626 and $1,246,997 in dividend income and $462,230 and $586,472 in interest income during 1977 and 1976, respectively.

The portfolio of equity securities included gross unrealized gains and losses of $189,433 and $14,455,853, respectively at December 31, 1977. Net realized gains on the sale of securities, after applicable taxes, included in the determination of net earnings for 1977 and 1976 amounted to $42,655 and $581,526, respectively. The valuation allowance decreased $1,904,045 during 1976 as compared to the previous year and increased $5,614,988 during 1977.

UNCONSOLIDATED COMPANIES

Investments in and advances to unconsolidated companies at December 31, 1977 include:

Family Leisure Centers, Inc., at cost plus share of undistributed earnings since acquisition	$39,043,215
Other partially-owned affiliated companies, at cost plus share of undistributed earnings since acquisition	4,238,296
	$43,281,511

Family Leisure Centers, Inc. is a 50% owned corporate joint venture which is engaged in the operation of amusement parks. The Company's equity in net earnings of unconsolidated companies includes the net earnings of this joint venture in the amount of $501,512 for 1977 and $307,580 for 1976.

DEBT OBLIGATIONS

Long-term debt at December 31, 1977 included:

9⅞% notes maturing in 1983	$ 50,000,000
9% sinking fund debentures maturing in 1995; with annual payments of $2,500,000 required from 1978 through 1995	44,287,000
8.70% sinking fund debentures maturing in 1998; with annual payments of $3,000,000 required from 1979 through 1998	60,000,000
8½% sinking fund debentures maturing in 2001, with annual payments of $2,500,000 required from 1982 through 2001	50,000,000
5% to 11% notes; annual payments due in varying amounts through 1996	17,096,445
	$221,383,445
Less amount due within one year	5,805,154
	$215,578,291

Under certain of the loan agreements, payments of cash dividends are limited. Under the most limiting agreement, accumulated earnings were unrestricted in the amount of $121,000,000 at December 31, 1977.

Short-term borrowings of the Company averaged $5,540,000 and ranged up to $11,000,000 during 1977 at a weighted average annual interest cost of 6.9%.

TAXES BASED ON INCOME

The provision for taxes based on income consists of:

	1977	1976
Federal		
Current	$27,126,705	$19,304,410
Deferred	9,888,295	9,575,590
	$37,015,000	$28,880,000
State and Local		
Current	9,597,380	8,201,939
Total	$46,612,380	$37,081,939

The provision for taxes based on income is lower than the normal statutory corporate tax rate principally due to investment tax credits which reduced the tax provision by $8,217,000 in 1977 and $7,015,000 in 1976.

The Company follows the practice of reinvesting permanently the earnings of subsidiaries in order to meet the requirements of the business and, therefore, has not considered any additional tax provision to be appropriate. Undistributed earnings, exclusive of those amounts which if remitted in the near future would result in little or no tax because of current income tax laws, are not material in amount.

COMMON STOCK

Changes in common stock during 1976 and 1977 were as follows:

	Issued		Treasury	
	Shares	Amount	Shares	Amount
Balance, Dec. 27, 1975	13,745,803	$88,621,758	256,673	$8,761,434
Exercise of options	17,403	300,075		
Balance, Jan. 1, 1977	13,763,206	$88,921,833	256,673	$8,761,434
Exercise of options	88,920	1,739,211		
Acquired			33,554	896,657
Balance, Dec. 31, 1977	13,852,126	$90,661,044	290,227	$9,658,091

PREFERRED STOCK

The Company has authorized 750,000 shares of voting cumulative preferred stock. The stock has a par value of $50 per share and is issuable in series. None is outstanding at December 31, 1977.

SEGMENTS OF BUSINESS

In compliance with Statement of Financial Accounting Standards No. 14, the Company's segments of business information at December 31, 1977 and for the year then ended is as follows:

	Food Business	Drug Stores	Adjustments and Eliminations	Consolidated
Outside sales	$6,220,586,038	$526,966,852		$6,747,552,890
Intersegment sales	14,007,270		$(14,007,270)	
Total sales	$6,234,593,308	$526,966,852	$(14,007,270)	$6,747,552,890
Operating profit	$ 121,023,471	$ 16,800,798		$ 137,824,269
General corporate expenses				11,161,795
Interest expense				20,906,707
Earnings before taxes based on income and equity in net earnings of unconsolidated companies				$ 105,755,767
Identifiable assets at December 31, 1977	$1,024,503,541	$158,454,795		$1,182,958,336
Investments in and advances to unconsolidated companies				43,281,511
Corporate assets				187,691,690
Total assets at December 31, 1977				$1,413,931,537

Intersegment sales prices are established on the basis of outside competitive market prices. Depreciation and amortization for Food Business and Drug Stores amounted to $52,499,733 and $2,965,587, respectively. Capital expenditures for Food Business and Drug Stores amounted to $90,851,516 and $1,781,326, respectively.

Certain unconsolidated companies' operations are vertically integrated with the Food Business. The investment in net assets and equity in net earnings of these unconsolidated companies amounted to $4,238,296 and $1,001,655, respectively. All companies operate within the United States.

STOCK OPTION PLANS

At December 31, 1977, options were outstanding to purchase 591,100 shares of common stock under the 1965, 1969 and 1976 Stock Option Plans (of which options on 326,711 shares were exercisable at that date) at prices ranging from $15.56 to $26.13 a share. Each option outstanding was granted at an option price equal to the fair market value of the stock at the date of grant. No further options may be granted under the 1965 Plan. Options may be granted under the 1969 and 1976 Plans until 1979 and 1986, respectively. At December 31, 1977, shares of common stock available for future options under the 1969 and 1976 Plans amounted to 386 shares and 214,883 shares, respectively.

Changes during 1977 in options outstanding under the Stock Option Plans of the Company were as follows:

	Shares Subject To Option	Option Price Range Per Share
Outstanding		
January 1, 1977	584,203	$15.56 - $24.00
Granted	138,150	$25.50 - $26.13
Exercised	(88,920)	$15.56 - $23.69
Cancelled or expired	(42,333)	$15.56 - $23.25
Outstanding		
December 31, 1977	591,100	$15.56 - $26.13

LITIGATION

There are pending against the Company various claims and lawsuits arising in the normal course of business including, as of December 31, 1977, suits charging violations of certain antitrust and civil rights laws. Some of these suits purport or have been determined to be class actions and/or seek damages in very large amounts. Any damages that may be awarded in antitrust cases will be automatically trebled.

Sixteen antitrust suits alleging, among other things, price-fixing in the purchase and sale of meat, have been or are in process of being consolidated for pretrial and discovery purposes in the United States District Court in Dallas. On December 27, 1977, the Court entered a judgment dismissing nine of these suits which had been filed in 1975 and 1976. As of February 21, 1978, appeals had been filed in eight of the dismissed suits and the time for filing an appeal in the other dismissed suit had not expired. The complaints in the remaining seven suits, which were filed in 1977, include certain allegations not contained in the earlier filed suits. Since discovery has been very limited, and since each of the suits, if tried at all, may go to a jury, the Company cannot predict their ultimate outcome. The Company believes, however, that it has substantial defenses available and should prevail in all.

Although the amount of liability at December 31, 1977 with respect to all claims and lawsuits cannot be ascertained, the Company is of the opinion that any resulting liability will not have a material effect upon the Company's financial position.

QUARTERLY FINANCIAL DATA (UNAUDITED)

Quarterly sales, merchandise costs, net earnings and net earnings per share of common stock for 1977 and 1976 are presented on page 10.

For information with respect to non-recurring items which occurred during the third quarter of 1976, see note Non-recurring Items.

REPLACEMENT COST (UNAUDITED)

As required by the Securities and Exchange Commission, current replacement cost information for certain assets and certain costs and expenses are to be disclosed in the Company's Form 10-K filed with the Commission.

The current replacement cost of the Company's affected inventories and productive capacity and the amount of the associated merchandise costs and depreciation expense calculated using replacement costs are generally higher than the comparable historical cost amounts shown in the financial statements.

FIVE YEAR SUMMARY

OPERATIONS

(thousands of dollars; except per share figures)

	1977	1976	1975	1974	1973
Sales	$ **6,747,553**	6,182,991	5,421,296	4,893,384	4,319,960
Costs and Expenses, excluding Taxes Based on Income	$ **6,641,797**	6,098,620	5,362,661	4,812,142	4,266,611
Taxes Based on Income	$ **46,612**	37,082	24,738	36,708	23,777
Equity in Net Earnings of Unconsolidated Companies	$ **1,503**	1,042	544	705	344
Net Earnings	$ **60,647**	48,331	34,441	45,239	29,916
Dividends	$ **20,551**	18,577	18,298	18,088	17,461
Per Share					
Net Earnings	$ **4.49**	3.58	2.55	3.36	2.22
Dividends	$ **1.52**	1.38	1.36	1.34½	1.30

BALANCE SHEET STATISTICS

(thousands of dollars, except per share figures)

	1977	1976	1975	1974	1973
Inventories	$ **623,645**	558,347	500,110	490,640	438,219
Working Capital	$ **298,461**	302,198	220,266	164,139	229,095
Property, Plant and Equipment, net	$ **453,267**	422,117	417,701	409,788	344,088
Total Assets	$ **1,413,932**	1,325,370	1,185,898	1,153,046	1,077,517
Long-Term Debt	$ **215,578**	232,983	182,584	130,325	151,471
Shareowners' Equity	$ **493,118**	457,795	425,837	420,208	392,852
Per Share of Common	$ **36.36**	33.89	31.57	31.16	29.15

OTHER STATISTICS

(dollars and shares in thousands)

	1977	1976	1975	1974	1973
Capital Expenditures	$ **96,417**	81,906	70,161	116,720	70,244
Depreciation and Amortization	$ **56,930**	52,948	51,195	46,054	44,510
Rent	$ **102,176**	96,506	87,350	79,786	71,925
Interest Expense	$ **20,907**	18,076	16,641	14,728	12,199
Dividend and Interest Income	$ **8,455**	7,305	4,945	4,998	4,543
Common Shares Outstanding	**13,562**	13,507	13,489	13,487	13,477
Number of Shareowners	**40,123**	42,508	44,941	45,766	46,436

RETAIL FACILITIES

(areas in thousands of square feet)

	1977	1976	1975	1974	1973
Supermarkets					
Opened	**98**	90	71	83	80
Remodeled	**35**	33	40	84	68
Closed	**83**	137	92	127	160
Stores — End of Year	**1,188**	1,173	1,220	1,241	1,285
Total Area	**28,642**	26,850	26,415	25,594	24,706
Drug Stores					
Opened	**11**	20	56	64	36
Closed	**41**	13	27	35	19
Stores — End of Year	**528**	558	551	522	493
Total Area	**6,108**	6,399	6,234	5,633	4,883

The Kroger Co.

1014 Vine Street, Cincinnati, Ohio 45201
Telephone: 513-381-8000

OPERATING AND STAFF VICE PRESIDENTS

CORPORATE STAFF

STUART M. BERMAN, *Planning*
CARL W BRIESKE, *Tax Counsel*
ROBERT L. COTTRELL, *Procurement and Trade Relations*
PAUL A GIBSON, *Personnel*
DON A HIRSCH, *Labor Relations*
LORRENCE T KELLAR, *Capital Management*
C. MANLY MOLPUS, *Public Affairs*

KROGER FOOD STORES

Headquarters Staff

BOBBIE L. CRISWELL, *Distribution Operations*
DONALD F DUFEK, *Store Operation Services*
F LELAND DAVIS, *Advertising*
RICHARD W. GOFF, *Meat Plant Operations*
J WAYNE HARRIS, *Produce Merchandising*
JACK G HUDSON, *Controller*
GEORGE L IRWIN, *Delicatessens/Bakeries*
THADDEUS J KACZMAROWSKI, *Facility Engineering*
RICHARD D SCHILL, *Kroger Sav-On*
ADRIAN L VANNICE, *Grocery Merchandising*
WALTER W. WHITE, *Distribution Administration*

Retail Operations

RICHARD L BERE, *Columbus Marketing Area*
DONALD J. BERENS, *Nashville Operations*
NEWTON W BRIGGS, *Dallas Marketing Area*
DAVID A BURT, *Michigan Marketing Area*
RONALD G. DAUGHERTY, *Indianapolis Operations*
WALTER R DRYDEN, *Southland Marketing Area*
THEODORE ENGEL, *Central Marketing Area*
ROBERT G EVERINGHAM, *Houston Marketing Area*
ROBERT L. HAYDEN, *Market Basket Marketing Area*
JAMES A. LeROY, *Delta Marketing Area*
ROBERT E SAFFRON, *Cincinnati Marketing Area*
NERVILLE A SAWALL, *Gateway Marketing Area*
EDWIN A SIEVEKING, *Mid-Atlantic Marketing Area*
CHARLES W. WHITE, *Louisville Marketing Area*
GERALD L WOLKEN, *Erie Marketing Area*

KROGER MANUFACTURING

FERD M. KISRO, *Poultry and Egg Division*
GEORGE M. LAUGHLIN, *Grocery Products Division*
NORBERT J PANKO, *Controller*
WILLIAM R PUGH, *Baked Foods Division*
RONALD R RICE, *Dairy Foods Division*
WILLIAM HAROLD WALL, *Business Development*
ROBERT M WILLIAMS, *Research and Developmental Engineering*

SUPERx DRUG STORES

Headquarters Staff

N. RONALD ADAMS, *Finance*
GENE M BEARD, *Finance, Administrative and Operational Control*
ALBERT G HARSNETT, *Sales*
WILLIAM J. HOWE, *Administrative Services*
WILLIAM R. JOHNSON, *Business Planning*

Retail Operations

CLARENCE H. ARCHER, *South West Region*
RONALD R. BAUMGARTH, *North East Region*
GARY E HENDREN, *North Central Region*
GORDEN P. SAUE, *South East Region*
BRIAN S. HOLT, *Marketing*

TOP VALUE ENTERPRISES, INC.

THOMAS H TOWLER, *President*

DIRECTORS

H. U. ANDREAE, *Former President,* The Jeffrey Company

JAMES E. BAKER, *Vice President*

WILLIAM W. BOESCHENSTEIN, *President,* Owens-Corning Fiberglas Corporation

RAYMOND B. CAREY, JR., *Chairman of the Board and President,* American District Telegraph Company

LYLE EVERINGHAM, *President*

JAMES P. HERRING, *Chairman of the Board and Chief Executive Officer*

JACKSON C. HINDS, *Chairman of the Board and President,* Entex, Inc

PATRICIA SHONTZ LONGE, *Professor, Business Administration,* University of Michigan

T. BALLARD MORTON, JR., *President,* Orion Broadcasting, Inc

THOMAS H. O'LEARY, *President,* Missouri Pacific Corporation

JOHN D. ONG, *President and Chief Operating Officer,* The B. Goodrich Company

W. GEORGE PINNELL, *Executive Vice President,* Indiana University

R. NELSON SHAW, *Director and Former Chairman,* Mercantile Stores Company, Inc.

EDWARD D. SMITH, Hansell, Post, Brandon & Dorsey

MORLEY P. THOMPSON, *President,* Baldwin-United Corporation

CORPORATE OFFICERS

RAYMOND F. ABARAY, *Vice President*

JAMES E. BAKER, *Vice President*

ROBERT W. BRAUNSCHWEIG, *Vice President*

JOHN A. CORNETT, *Senior Vice President*

LYLE EVERINGHAM, *President*

JAMES P. HERRING, *Chairman of the Board and Chief Executive Officer*

ARTHUR JUERGENS, *Vice President*

WILLIAM G. KAGLER, *Senior Vice President*

GEORGE W. KEITH, *Vice President President,* SupeRx Drug Stores

RICHARD M. KOSTER, *Group Vice President*

GEORGE A. LEONARD, *Vice President Secretary and General Counsel*

WILLIAM W. OLIVER, *Group Vice President*

ROBERT E. SAFFRON, *Vice President*

JOHN L. STRUBBE, *Group Vice President*

CHARLES L. THOMAS, *Group Vice President*

IRLE R. HICKS, *Treasurer*

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